The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, JANUARY 25, 1982 VOLUME XIX, NUMBER 4

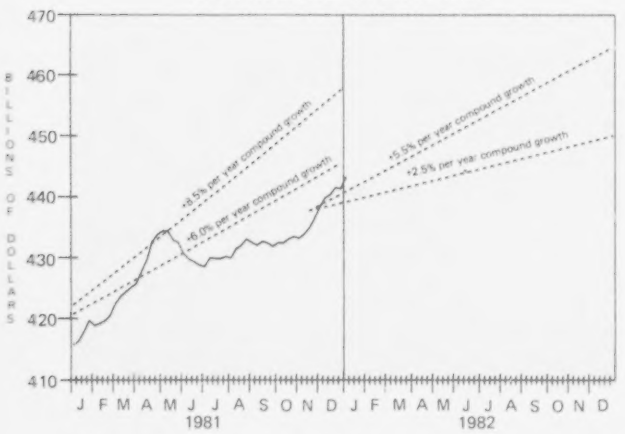
B 5350-2

The Bulge In The Money Supply . . .

One of the more disturbing economic developments occurring in recent weeks has been the sharp bulge in the money supply, and the attendant backup of short- and long-term interest rates. Despite evidence of a deep recession, spreading joblessness and a continued moderation of rates of inflation, money supply growth has ballooned and interest rates are moving higher. Already, M1 is well above its upper growth target boundary for 1982 which, together with the extremely bleak Federal budget outlook, have again raised the specter of a significant tightening of the monetary reins.

Not surprisingly, this prospect has led to a reversal of much of last autumn's money and bond market gains. During the four weeks ending January 20, for example, short-term interest rates rose by as much as 125 basis points, while top-quality corporate bond yields increased up to 116 basis points. But, with the economy remaining weak and the growth of short-term business credit demands expected to slow due to both seasonal and cyclical factors, money supply growth should ease and additional interest rate declines may occur in the weeks ahead (Financial Digest—January 4, 1982).

MONEY SUPPLY, M1
FOUR-WEEK MOVING AVERAGE



While the recent behavior of the monetary aggregates and short-term business credit demands suggest a bottoming of the recession and the imminent onset of a rebound in the pace of economic activity, all the other data on the performance of the economy do not. Surveys of households, businesses and purchasing agents all indicate that the trough of the recession may still be a few months away, while recent indicators of economic activity seem to confirm this conclusion. Among the more important were the fourth consecutive monthly decline in the index of leading economic indicators in November, the very weak pace of new automobile sales and new-home construction, the sharp drop in industrial production in December (the fifth consecutive monthly decline) and a further increase in the unemployment rate. To top it off, the real gross national product fell for the fourth time in eleven calendar quarters, while the annual rise in consumer prices in 1981 slowed to 8.9 per cent – the smallest yearly gain since 1977.

. . . Raises A Difficult Dilemma . . .

As a result of this contradiction between the behavior of the money supply and interest rates and the pervasive weakness affecting the economy, the Federal Reserve is now confronted with a difficult policy dilemma. As shown in the chart, the source of the Fed's problem arises from the growth of its key monetary aggregate M1—it is already above its 5½ per cent upper target boundary for 1982. With the Fed committed to controlling the supply of credit, rather than its price, some policy response is likely. But selecting the appropriate response is not without its problems. For example, the Fed could move quickly to bring M1 growth back within its target range by curtailing the provision of nonborrowed reserves to the banking system. However, this would produce another sharp run-up in interest rates and reduce the chances for an economic recovery to begin anytime soon. With rising joblessness becoming more important and inflation less so, such a tightening of credit could provoke a political firestorm in Washington.

Alternatively, the Fed could sit tight and be cautious. If the economy is as weak as it appears, then money supply growth will decelerate on its own in coming weeks and the problem will correct itself. The risk in this course of action is that if the central bank disregards the current bulge in the money supply and M1 stays permanently higher,

Copyright 1982
Manufacturers Hanover Trust Company
350 Park Avenue, New York, NY 10022

investor fears of too rapid money supply growth, along with concerns over the dismal Federal budget outlook, could be devastating for the financial markets. The fallout would affect not only the near-term outlook, but the longer run as well, due to the almost certain revival of inflation psychology.

Against this backdrop, it appears a good bet that monetary policy will remain in a holding pattern—at least until either the recession deepens or the bulge in the money supply does indeed prove permanent. The situation is simply too unclear to justify an aggressive policy turn in either direction. However, if M1 continues to move to even higher levels, then the possibility of a sharp turn toward restraint will loom larger.

. . . For The Federal Reserve

Such a tightening of the credit reins in the midst of a deep recession with receding inflation would seem peculiar. The economy has probably not yet reached bottom, with inventory workdowns still to come, business spending likely to remain sluggish due to lackluster sales and earnings prospects and household spending adversely affected by the perverse "wealth" effects of slumping equity, bond and home prices. But this implies that money supply growth should soon ease even in the absence of renewed restraint by the Fed, once the current surge is past. Money supply gains at this time appear to be related to Fed decisions made two and three months ago at the onset of the current recession, rather than

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 1/13/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	136.423	– 3.955	+ 7.141
Loans to Depository Inst.	.997	– .457	– .335
Float	4.145	+ .513	– .344
Total Reserve Bank Credit	150.849	– 4.105	+ 7.158
Treasury Deposits with Federal Reserve Banks	3.069	– .678	– .016
Currency Outside Banks	126.620	– 2.463	+ 7.108
Member Bank Reserves:			
Required	42.175	+ .030	+ .935
Excess (Deficiency)	.233	– .511	– .508
Total Reserves Held	42.408	– .481	+ .427
Net Borrowed Reserves	.711	+ .060	+ .225
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.806	+ .727	– 3.823

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	451.3	+ 12.6‡	+ 7.1‡
M2 (December '81)	1,842.2	+ 12.4	+ 10.4
M3 (December '81)	2,187.1	+ 10.0	+ 11.3
L (September '81)	2,574.4	+ 11.4	+ 11.5

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 1/22/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	12.20%	12.70%	12.80%
* Federal Agencies	12.80	14.04	14.20
* Project Notes–Taxfree (46% Taxable Equivalent)	11.57	13.15	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	14.05	14.75	16.00

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	12.50%	Feb.	13.00%
15- 29 days	12.75	Mar.	13.00
30- 59 days	12.75	Apr.	13.20
60- 89 days	13.00	May	13.40
90-179 days	12.50	Jun.	13.65
180-239 days	12.50	Jul.	13.50
240-270 days	12.00		

‡Industrial Paper–Prime			
30- 89 days	13.13%	†Federal Funds Effective Rate	13.65%
90-120 days	13.25		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'81n	$ 2,985	$ 2,965	$ 2,731
Gross National Product (1972 Dollars)*	4th Q'81n	$ 1,496	$ 1,516	$ 1,486
Percent Change, Annual Rate	4th Q'81n	– 5.2	1.4	3.8
Change in Consumer Prices (all urban consumers)*	Dec '81n	4.8%	6.0%	12.0%
Change in Producer Prices*	Dec '81	3.6%	6.0%	4.8%
Civilian Employment (Thousands of Persons)†	Dec '81	97,188	98,025	97,282
Unemployment as % of Civilian Labor Force†	Dec '81	8.9%	8.4%	7.4%
Personal Income	Dec '81n	$ 2,492	$ 2,488	$ 2,277
Leading Indicators Composite Index (1967=100)†	Nov '81	127.8	128.2	136.5
Industrial Production Index (1967=100) †	Dec '81	143.3	146.4	150.4
Net Change in Consumer Installment Credit†	Nov '81	$ 0.34	$ 1.01	$ 0.84
U.S. Merchandise Trade Balance †	Nov '81	–$ 3.40	–$ 4.19	–$ 1.15
Plant and Equipment Expenditures*	1st Q'82	$345.46(a)	$332.69(a)	$312.24
Private Housing Starts (Thousands of Units)*	Dec '81n	978	863	1,535
New Construction Expenditures*	Nov '81	$ 230.3	$ 229.8	$ 234.3
Total Business Inventories†	Nov '81	$ 515.2	$ 511.7	$ 474.9
Total Business Sales†	Nov '81	$ 344.6	$ 345.3	$ 339.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

to any residual economic strength.

While the slowing of money supply growth would tend to stabilize the financial markets, the current predicament is undoubtedly causing the Fed to review its monetary growth targets for 1982. On a preliminary basis, these have been set at 2½-5½ per cent for M1 and six to nine per cent for M2. Whether they will be significantly altered remains to be seen; the adverse psychological impact of raising the annual targets may be deemed too costly. What the central bank could do, however, would be to leave the growth boundaries themselves unchanged, but set the starting points from which the targets are calculated at the higher December levels instead of the lower fourth quarter averages, as is the case at the moment. This switch alone would eliminate much of the dilemma; as of the latest four-week average, M1 is only slightly above its upper target boundary using a December, rather than fourth quarter, base.

But with the real GNP down at a steep 5.2 per cent annual rate in the fourth quarter, and evidently still contracting in the first, one step which the Fed probably will take is to set its short-term money growth targets at or above the top end of whatever annual target ranges are decided upon. This, in turn, would allow the Fed more policy leeway in the first quarter than now appears likely—at least more than that suggested by the annual growth targets. H

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (1/6/82)	132,142	– 3,958	+17,589
New York City (1/6/82)	32,050	– 1,978	+ 2,896
Commercial Paper (1/6/82)	163,207	+ 421	+37,969

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/6/82)	195,980	+ 284	+22,802
New York City (1/6/82)	55,802	– 423	+ 4,559

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (1/6/82)	471,470	+ 1,547	+39,142
New York City (1/6/82)	111,128	– 848	+ 7,789

Financial Markets

	Friday 1/22/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	13.89%	+ 1	– 2.65
180-Day Bills†	14.81	+ .[illegible]	– 1.19
Longest Bills†	14.86	+ .31	+ .11
Recent Issues:			
13s 12/31/83	13.46	– 2.20	
14 1/8s 12/31/85	15.65	+ .42	
14 1/4s 11/15/91	15.58	+ .68	
14s 11/15/11	14.54	– .06	
Municipals:			
Bond Buyer–20 Bond Index* (1/21/82)	13.16%	– .28	+ 3.48
Blue List Total ($ Million)	$ 790	– $ 51	+ $ 141
30-Day Visible Supply ($ Million)	$1,904	+ $333	+ $ 161
Total	$2,694	+ $282	+ $ 302
Corporates:			
Moody's Aa Composite (1/21/82)	15.82%	+ .12	+ 2.17
30-Day Visible Supply ($ Million)	$9,177	– $ 75	+ $4,706
Stocks:			
Dow-Jones Averages:			
Industrials	845.03	– 2.57	– 95.16
Transportation	342.03	– 10.60	– 49.58
Utilities	104.06	– .12	– 7.70
65 Stocks	327.96	– 3.67	– 37.31
Standard and Poor's 500 Stocks	115.38	– .95	– 14.85
N.Y.S.E. Composite Index	66.78	– .63	– 7.94
N.Y.S.E. Avg. Daily Vol. for Week (000's)	46,420	– 1,036	+ 7,456

* 46% Taxable equivalent 24.37%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 1/22/82	Week Ago
Overnight	13.75%	12.50%
1 month	13.88	13.44
3 month	14.56	14.06
6 month	15.31	14.81
1 year	15.38	15.06
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	14.95%	14.85%
Long Term (7 to 15 yrs.)	15.20	15.20

FOREIGN EXCHANGE SPOT RATES

New York Opening (1/22/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02552	39.19
Canada	.8382	1.1930
Denmark	.1328	7.5308
France	.1708	5.8565
Germany	.4344	2.3020
Italy	.0008098	1234.90
Japan	.004416	226.43
Mexico	.03771	26.52
Netherlands	.3964	2.5225
Switzerland	.5408	1.8490
U.K.	1.8697	.5348

SECURITIES BLANKET.

Certain designs © Cranston Print Works Company.

Here's something comforting to take hold of: the complete, coordinated securities services of Manufacturers Hanover.

MHT has developed one of the most sophisticated systems available for reporting, processing and settlement of securities. Our system allows you to communicate directly with MHT via a dial-up terminal in your offices. So you know, as quickly as possible, which funds will be available when.

MHT has long championed book-entry depository processing. As a major participant in the Depository Trust Company and the Federal Reserve book-entry program, we can help you gain the benefits of the depository environment — like reducing the high costs of holding and moving physical certificates.

In the safekeeping area, too, MHT offers distinct advantages. Like our leadership as a processing agent. And our proven ability to handle depository ineligibles, such as Commercial Paper, Bankers Acceptances, Certificates of Deposit and Municipals.

Questions? For answers and descriptive literature, contact your National Division representative. Or call Brian V. Carty, Vice President, at (212) 350-4658.

It's like having a securities security blanket.

MANUFACTURERS HANOVER

America's premier correspondent bank

National Division, 350 Park Avenue, New York, N.Y. 10022

Member FDIC